Elbit Systems Ltd.
Management's Report
For the Year Ended December 31, 2005

This report should be read together with the audited consolidated financial statements and related notes of Elbit Systems Ltd. ("Elbit Systems" and together with its subsidiaries, the "Company" or the "Group") for the year ended December 31, 2005 and the Company's Form 20-F for the year ended December 31, 2004, filed by the Company with the U.S. Securities and Exchange Commission ("SEC") and with the Israeli Securities Authority.

Forward looking statements with respect to the Company's business, financial condition and results of operations in this document are subject to risks and uncertainties that could cause actual results to differ materially from those contemplated in such forward looking statements, including, but not limited to, product demand, pricing, market acceptance, changing economic conditions, risks in product and technology development, the effect of the Company's accounting policies as well as certain other risk factors which are detailed from time to time in the Company's SEC filings.

A. Executive Overview

Business Description

Elbit Systems and its subsidiaries (the "Group") operate in the areas of aerospace, land and naval systems, command, control, communications, computers, intelligence, surveillance and reconnaissance ("C^4ISR"), advanced electro-optic and space technologies, EW suites, airborne warning systems, ELINT systems, data links and military communications systems and equipment. The Group also focuses on the upgrading of existing military platforms and developing new technologies for defense and homeland security applications.

The Group provides support services for the platforms it upgrades as well as the systems and products it supplies. In addition, the Group provides a wide range of logistic support services, including operation of pilot training services for the Israeli Air Force on a private financing initiative basis. Several of the Group's companies also provide advanced engineering and manufacturing services to various customers, utilizing their significant manufacturing capabilities. The Group often cooperates with industries in Israel and in various other countries.

The Group tailors and adapts its technologies, integration skills, market knowledge and battle-proven systems to each customer's individual requirements in both existing and new platforms. By upgrading existing platforms with advanced electronic and electro-optic technologies, the Group provides customers with cost-effective solutions, and its customers are able to improve their technological and operational capabilities within limited defense budgets.

The Group operates in a competitive environment for most of its projects, systems and products. Competition is based on product and program performance, price, reputation, reliability, maintenance costs and responsiveness to customer requirements. This includes the ability to respond to rapid changes in technology. In addition, its competitive position sometimes is affected by specific requirements in particular markets.

Financial Highlights

The Company's revenues increased by 13.8% and reached $1,070 million in 2005, as compared to $940 million in 2004.

Net earnings in 2005 were $32.5 million and the diluted earnings per share were $0.78, as compared to $51.9 million and $1.26, respectively in 2004.

Excluding a one-time In Process Research and Development ("IPR&D") write-off of $8.5 million related to the acquisition of Tadiran Communications Ltd.'s shares and a one-time IPR&D and other write-offs in the amount of $10.1 million related to the acquisition of Elisra Electronic Systems Ltd.'s ("Elisra") shares, net earnings in 2005 were $51.1 million, and the diluted EPS was $1.23, as compared to $52.9 million and an a diluted EPS of $1.29 in 2004.

The Company's results also reflect a write-off of $5.4 million in the fourth quarter of 2005, due to value impairment in its holdings in ImageSat International N.V. (see "Other Expenses (Net)" below).

The Company's backlog as of December 31, 2005 reached $3.35 billion, as compared to $2.15 billion as of December 31, 2004, an increase of 55%.

The Company's cash flow generated from operations in the year ended December 31, 2005 was $187.6 million, as compared to $81.5 million in the year ended December 31, 2004.

The Board of Directors declared a dividend of $0.14 per share for the last quarter of 2005.

B. Market Trends

Trends in the defense electronics and homeland security markets in which the Company operates have been impacted by the nature of recent conflicts and terrorism activities throughout the world. Lessons learned in Operation Iraqi Freedom, Afghanistan and various terrorist actions worldwide have increased the focus of defense forces on low intensity conflicts and homeland security.

In the defense electronics market, there is an increasing demand for products and systems in the areas of C^4ISR. Accordingly, while the Company continues to perform platform upgrades, more emphasis is being placed on C^4ISR, including information systems, intelligence gathering, situational awareness, precision guidance, all weather and day/night operations, border and perimeter security, UAV's, space and satellite based defense capabilities and homeland security systems.

The Company believes that its core technologies and abilities will enable it to take advantage of many of these emerging trends, as well as to continue to participate in the "Current Force" legacy operations of its customers.

In recent years consolidations in the defense industry have affected competition. This has decreased the number but increased the relative size and resources of the Company's competitors. The Company adapts to evolving market conditions by adjusting its business strategy to changing defense market conditions. It also anticipates continued competition in defense markets due to declining defense budgets in some countries.

The Company believes in its ability to compete on the basis of its systems development and technological expertise, combat-proven performance and policy of offering customers overall solutions to technological, operational and financial needs and in the same time enhancing the industrial capabilities at these countries.

C. Backlog of Orders

The Company's backlog of orders as of December 31, 2005 reached $3,347 million (including $340 million in backlog related to Elisra that was acquired in the fourth quarter of 2005), of which 72% were for orders outside Israel. The Company's backlog as of December 31, 2004 was $2,154 million, of which 66% were for orders outside Israel.

Approximately 65% of the Company's backlog as of December 31, 2005 is scheduled to be performed during 2006 and 2007. The majority of the 35% balance is scheduled to be performed in 2008 and 2009.

D. Operating Subsidiaries and Affiliated Entities

- Elbit Systems Electro-Optics Industries El-Op Ltd. ("El-Op") - a wholly-owned subsidiary based in Israel, is engaged in the area of advanced electro-optical products and systems for military and civilian use. El-Op's business areas include thermal imaging products, lasers, IMINT solutions, head-up displays, integrated sights for ground forces, space and airborne reconnaissance systems and electro-optical homeland security and defense security systems.

- Elbit Systems of America ("ESA") – is the headquarters for the U.S. operations of the Group and includes the following companies:

    - EFW Inc. ("EFW"), a wholly-owned subsidiary based in Fort Worth, Texas, provides combat-proven design, development, production and life-cycle support of mission critical systems for U.S. and allied military tactical platforms.

    - Kollsman, Inc. ("Kollsman"), a wholly-owned subsidiary located in Merrimack, New Hampshire, is a supplier of avionic equipment, electro-optic systems and subsystems, vision based solutions and surveillance systems to the commercial aviation, defense and homeland security markets.

    - International Enterprises, Inc. ("IEI"), a wholly-owned subsidiary based in Talladega, Alabama, provides depot level repair, manufacturing and logistics support for military electronic systems and components.

    - Vision Systems International LLC ("VSI"), a 50% joint venture with Rockwell Collins, located in San Jose, California, is a supplier of helmet mounted cueing systems for fixed-wing, tactical fighter aircraft.

- Cyclone Aviation Products Ltd. ("Cyclone") – a wholly-owned subsidiary based in Israel, is engaged in the production of structural components and parts for leading aerospace companies. Cyclone also performs maintenance, repair and customized upgrading of light airplanes and helicopters.

- Silver Arrow LP – a wholly-owned limited partnership based in Israel, is engaged in UAV systems development, production and support and produces a full range of UAV systems for tactical use.

- Ortek Ltd. ("Ortek") – a wholly-owned subsidiary based in Israel, is engaged in the development and production of optical security systems and products and performs a range of projects for homeland security and defense applications.

- European subsidiary – a wholly-owned subsidiary based in Belgium, is involved mainly in development, manufacturing and support of electro-optical products for defense and space markets.

- Elisra – in which Elbit Systems owns a 70% interest, is comprised of Elisra Electronic Systems Ltd. ("Elisra"), a privately held Israeli company, and Elisra's two wholly-owned Israeli subsidiaries – Tadiran Electronic Systems Ltd. and Tadiran Spectralink Ltd. Elisra specializes in the design, manufacture, integration and support of advanced defense solutions and its main business areas include EW suites, airborne warning systems, ELINT systems, artillery C4I systems and data links for UAVs and guided munitions.

- Kinetics Ltd. ("Kinetics") – a 51%-owned subsidiary based in Israel, is involved mainly in the development and production of systems and components for combat vehicles.

- Semi-Conductor Devices ("SCD") – an Israeli affiliated partnership held in equal part by each of the Company and Rafael Armaments Development Authority Ltd. ("Rafael"), is engaged in the development and production of infrared detectors and laser diodes.

- Opgal Optronic Industries Ltd. ("Opgal") – an Israeli affiliated company, owned 50.1% by the Company and 49.9% by Galram Technologies Ltd., a wholly-owned subsidiary of Rafael, is engaged mainly in the area of thermal imaging systems for commercial applications.

- Tadiran Communications Ltd. ("Tadiran") – a publicly-traded Israeli company in which Elbit Systems holds an approximately 40% interest, is engaged in the worldwide market for military communications systems and equipment and is also active in the civilian communications market.

The Company has holdings, directly and indirectly, in several relatively small companies in various countries. These companies are engaged mainly in the manufacturing, marketing and servicing of defense avionics and electronics as well as defense related software.

The Company also has holdings, directly and indirectly, in several non-defense technologies spin-off companies whose activities are usually based on technologies that were developed by the Group. The spin-off companies are involved primarily in the areas of medical equipment and space satellites.

The Company evaluates investments in affiliates, partnerships and other companies, and when relevant factors indicate other than temporary decline in the fair value of the investments below their carrying value, the Company adjusts the investment to the estimated fair value. The value of these companies is subject to ongoing changes resulting from their business conditions.

E. Recent Events

- On December 4, 2005, the Company announced that it signed an approximately €57 million contract for a helicopter upgrade program with the Bulgarian Ministry of Defense. This program was the subject of previous announcements by the Company on December 21, 2004 and March 10, 2005.

- On December 12, 2005, the Company reported that its U.S. subsidiary Kollsman, was awarded initial orders in the amount of $33.6 million to provide high performance Thermal Binocular System Long Range Thermal Imagers (LRTI) for the U.S. Marine Corps. Under the indefinite delivery / indefinite quantity (IDIQ) contract the U.S. Government may purchase up to 5,000 LRTI's as well as spare parts, contractor maintenance and training items over a five-year period. Therefore, there is the potential for up to $250 million in additional orders to Kollsman.

- On December 18, 2005, the Company announced that its subsidiary El-Op was selected by the Korean Air Force to supply Real Time EO/IR Long Range Oblique Imagery Systems for the ROKAF's F-16 Aircraft. The contract, valued at approximately $50 million, will be performed over a multi-year period.

- On January 2, 2006, the Company reported that its 70%-owned subsidiary, Elisra completed the finalization process of a contract valued at approximately $80 million to supply full electronic warfare (EW) suites for fighter aircraft to an international customer. The contract will be performed over a three-year period.

- On January 4, 2006, the Company reported that its 40%-owned subsidiary, Tadiran announced that it expected to post a $10 million to $15 million net loss for the fourth quarter of 2005, resulted mainly from the loss of approximately $20 million in planned revenues due to a seven-week strike that ended on December 28, 2005, and to a one-time write-off that is expected to be recognized in connection with the anticipated early retirement of approximately 50 employees, as part of Tadiran's recently signed collective bargaining agreement.

- On February 2, 2006, the Company reported that it was selected to supply Unmanned Turrets systems for the Belgian Armored Infantry Vehicle Program in co-operation between the Company and the Swiss company Mowag, a part of the General Dynamics European Land Combat Systems Group. The anticipated contract value for the Company's portion of the Program amount is expected to be material to the Company. Deliveries are expected to take place between 2007 - 2012.

- On February 13, 2006, the Company announced that it expects to record in the fourth quarter of 2005 an estimated $20 million to $25 million in costs, which is related to its acquisition of a 70% interest in Elisra, the purchase of an additional 13% interest in Tadiran, the impact of certain developments that occurred in Tadiran during the fourth quarter of 2005 and value impairment in connection with companies in which the Company holds a minority interest.

F. Critical Accounting Policies and Estimates

The Company's significant accounting policies are described in Note 2 to the audited consolidated financial statements for the year ended December 31, 2005.

The Company's results of operations and financial condition are based on the preparation of consolidated financial statements in conformity with generally accepted accounting principles in the United States ("U.S. GAAP"). The preparation of the consolidated financial statements requires management to select accounting policies for critical accounting areas as well as estimates and assumptions that affect the amounts reported in the consolidated financial statements. Significant changes in assumptions and/or conditions and changes in critical accounting policies could materially impact the Company's operating results and financial condition.

The most critical accounting policy applicable to the Company relates to revenue recognition as described below.

The Company generates revenues from long-term contracts involving the design, development, manufacture and integration of defense systems and products and providing support and services for such systems and products.

Revenues from long-term contracts are recognized based on Statement of Position 81-1 "Accounting for Performance of Construction-Type and Certain Production-Type Contracts" ("SOP 81-1") according to which revenues are recognized on the percentage-of-completion basis.

Sales under long-term fixed-price contracts which provide for a substantial level of development efforts in relation to total contract efforts are recorded using the cost-to-cost method of accounting as the basis to measure progress toward completing the contract and recognizing revenues. According to this method, sales and profits are recorded based on the ratio of costs incurred to estimated total costs at completion. In certain circumstances, when measuring progress toward completion, the Company considers other factors, such as achievement of performance milestones.

Sales and anticipated profit under long-term fixed-price production type contracts are recorded on a percentage-of-completion basis, using the units-of-delivery as the basis to measure progress toward completing the contract and recognizing revenues.

Sales and anticipated profit under long-term fixed-price contracts that involve both development and production are recorded on a percentage-of-completion basis, using the cost-to-cost method and units-of-delivery method as applicable. In certain circumstances, when measuring progress toward completion under the development portion of the contract, the Company considers other factors, such as achievement of performance milestones.

The percentage-of-completion method of accounting requires management to estimate the cost and gross profit margin for each individual contract. Estimated gross profit or loss from long-term contracts may change due to changes in estimates resulting from differences between actual performance and original estimated forecasts. Such changes in estimated gross profit are recorded in results of operations when they are reasonably determinable by management, on a cumulative catch-up basis. Anticipated losses on contracts are charged to earnings when determined to be probable.

Sales under cost-reimbursement-type contracts are recorded as costs are incurred. Applicable estimated profits are included in earnings in the proportion that incurred costs bear to total estimated costs.

Amounts representing contract change orders, claims or other items are included in sales only when they can be reliably estimated and realization is probable. Penalties and awards applicable to performance on contracts are considered in estimating sales and profit rates and are recorded when there is sufficient information to assess anticipated contract performance.

The Group believes that the use of the percentage-of-completion method is appropriate as the Group has the ability to make reasonably dependable estimates of the extent of progress towards completion, contract revenues and contract costs. In addition, contracts executed include provisions that clearly specify the enforceable rights regarding services to be provided and received by the parties to the contracts, the consideration to be exchanged and the manner and terms of settlement. In all cases the Group expects to perform its contractual obligations and its customers are expected to satisfy their obligations under the contract

In cases where the contract involves the delivery of products and performance of services, the Group follows the guidelines specified in EITF 00-21, "Revenue Arrangements with Multiple Deliverables" in order to allocate the contract fees between the products accounted for under SOP 81-1 and the services accounted for under SAB 104. The services are recognized throughout the service period.

In certain circumstances, sales under short-term fixed-price production type contracts are accounted for in accordance with SAB No. 104, "Revenue Recognition in Financial Statements" ("SAB 104"), and recognized when the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred, the seller's price to the buyer is fixed or determinable, no further obligation exists and collectability is reasonably assured.

As for research and development costs accounted for as contract costs refer to Note 2(T) to the Company's audited consolidated financial statements for the year ended December 31, 2005..

G. Impairment of Goodwill and Other Long-Lived Assets

Consistent with Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets," goodwill is not amortized and is tested at least annually for impairment. According to SFAS 142, an impairment loss will be recognized when the carrying value of the goodwill is not recoverable and exceeds its fair value.

The methods commonly used to value a closely held company are the Income, Market and Cost approaches. The Company's reported units fair market value was estimated using two valuation methodologies: the Income Approach and the Market Approach.

As of December 31, 2005, the Company's goodwill amounted to $64 million. The Company tested its goodwill as of December 31, 2005 and concluded that no assessment of impairment loss was necessary.

Consistent with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," the Company evaluates long-lived assets for impairment and assesses their recoverability based upon anticipated future cash flows. As of December 31, 2005, the Company's long-lived assets amounted to $363.8 million, including $78.8 million in intangible assets, and the Company concluded that no impairment loss was necessary.

Should future impairment tests made by the Company determine that impairment has occurred in the value of the Company's goodwill or long-lived assets, such impairment may have a material effect on the financial results of the Company in the period in which the impairment is determined. See also "Other Expenses (Net)" below.

H. Sarbanes-Oxley Act

According to Section 404 of the U.S. Sarbanes-Oxley Act of 2002, the Company is required to include in its annual report for the fiscal year ending December 31, 2006 an assessment, as of the end of the fiscal year, of the effectiveness of its internal controls over financial reporting.

During 2004 and 2005, the Company took steps to assure compliance of its documentation and internal controls over financial reporting with the guidelines stipulated in the Sarbanes-Oxley Act. The Company plans to continue with these steps during 2006.

I. New Accounting Standards

The significant accounting policies applied in the preparation of these statements are identical to those applied in preparation of the latest annual financial statements except as indicated below:

- On December 2004, the FASB issued the revised FAS No. 123, "Share-Based Payment" ("FAS 123(R)"), which addresses the accounting for share-based payment transactions in which the Company obtains employee services in exchange for: (a) equity instruments of the Company; or (b) liabilities that are based on the fair value of the Company's equity instruments or that may be settled by the issuance of such equity instruments. This Statement eliminates the ability to account for employee share-based payment transactions using APB 25, "Accounting for Stock Issued to Employees", and requires instead that such transactions be accounted for using the grant-date fair value based method. This Statement was to have been effective as of the beginning of the first interim or annual reporting period that commences after June 15, 2005 (July 1, 2005 for the Company); however, on April 14, 2005, the SEC delayed effectiveness for companies with fiscal years ending December 31, (such as the Company) to January 1, 2006. This Statement applies to all awards granted or modified after the Statement's effective date. In addition, compensation cost for the unvested portion of previously granted awards that remain outstanding on the Statement's effective date shall be recognized on or after the effective date, as the related services are rendered, based on the awards' grant-date fair value as previously calculated for the pro-forma disclosure under SFAS 123. In March 2005, the SEC released SEC Staff Accounting Bulletin No.107 (SAB 107), "Share-Based Payment" (SAB 107"). SAB 107 provides the SEC staff's position regarding the application of FAS 123(R) and contains interpretive guidance related to the interaction between FAS 123(R) and certain SEC rules and regulations and also provides the SEC staff's views regarding the valuation of share-based payment arrangements for public companies.

- In May 2005, the FASB issued Statement of Financial Accounting Standard No. 154 (“FAS 154”), "Accounting Changes and Error Corrections” - a replacement of APB No. 20, Accounting Changes” and FAS No. 3, “Reporting Accounting Changes in Interim Financial Statements“. FAS 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. APB Opinion 20 previously required that most voluntary changes in accounting principles be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. FAS 154 requires retrospective application to prior periods’ financial statements of a voluntary change in accounting principles unless it is impracticable to do so. FAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company estimates that the adoption of FAS 154 will not have a significant impact on its results of operations, financial condition and cash flows.

- In June 2005, the Emerging Issues Task Force ("EITF") released Issue No. 04-5 "Determining Whether a General Partner, or the General Partner as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights" ("EITF 04-5"). EITF 04-5 provides guidance in determining whether a general partner controls a limited partnership and therefore should consolidate the limited partnership. EITF 04-5 states that the general partner in a limited partnership is presumed to control that limited partnership and that the presumption may be overcome if the limited partners have either (1) the substantive ability to dissolve or liquidate the limited partnership or otherwise remove the general partner without cause or (2) substantive participating rights. The effective date for applying the guidance in EITF 04-5 was (1) June 29, 2005 for all new limited partnerships and existing limited partnerships for which the partnership agreement was modified after that date and (2) no later than the beginning of the first reporting period in fiscal years beginning after December 15, 2005, for all other limited partnerships. Implementation of EITF 04-5 did not have a material impact on the Company's financial position in fiscal 2005.

- In November 2005, the FASB issued FSP FAS 115-1. The FSP addresses the determination as to when an investment is considered impaired, whether that impairment is other than temporary, and the measurement of an impairment loss. The FSP also includes accounting considerations subsequent to the recognition of other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. The guidance in this FSP amends SFAS No. 115, Accounting for Certain Investments in Debt and Equity. The FSP replaces the impairment evaluation guidance of EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments," with references to the existing other-than-temporary impairment guidance. The FSP clarifies that an investor should recognize an impairment loss no later than when the impairment is deemed other-than-temporary, even if a decision to sell an impaired security has not been made. The guidance in this FSP is to be applied to reporting periods beginning after December 15, 2005. As of December 31, 2005, adoption of FSP FAS 115-1 has not had a material impact on the Company's financial position or results of operations.

J. Off Balance Sheet and Other Long-Term Arrangements and Commitments

- The Company and certain Israeli subsidiaries partially finance their research and development expenditures under programs sponsored by the Government of Israel Chief Scientist Office ("OCS") for the support of research and development activities conducted in Israel. At the time the participations were received, successful development of the related projects was not assured.

  In exchange for participation in the programs by the OCS, the Company and the subsidiaries agreed to pay 2% - 5% of total sales of products developed within the framework of these programs. The obligation to pay these royalties is contingent on actual sales of the products.

  The Company and some of its subsidiaries may also be obligated to pay certain amounts to the Israeli Ministry of Defense ("IMOD") and others on certain sales including sales resulting from the development of some of the technologies developed with their participation.

- In connection with long-term projects in certain countries, the Company and certain subsidiaries undertook to use their respective best efforts to make or facilitate purchases or investments in those countries at specified percentages (typically up to 100%) of the amount of the specific contract. The companies' obligation to make or facilitate third parties making such investments and purchases is subject to commercial conditions in the local market, typically without a specific financial penalty. The maximum aggregate undertaking as of December 31, 2005 amounted to $666 million to be performed over a period of up to 10 years. In the opinion of the Company's Management, the actual amount of the investments and purchases is anticipated to be less than that mentioned above, since certain investments and purchases can result in reducing the overall undertaking on more than a one-to-one basis.

- The future minimum lease commitments of the Group under various non-cancelable operating lease agreements in respect of premises, motor vehicles and office equipment are as of December 31, 2005 as follows: $13.1 million for 2006, $10.2 million for 2007, $8.6 million for 2008, $8.0 million for 2009 and 17.6 million for 2010 and thereafter.

- In connection with bank credits and loans, including performance guarantees issued by banks and bank guarantees in order to secure certain advances from customers, the Company and certain subsidiaries are obligated to meet certain financial covenants. Such covenants include requirements for shareholders' equity, current ratio, operating profit margin, tangible net worth, EBITDA, interest coverage ratio and total leverage. As of December 31, 2005, the Company and its subsidiaries, except Elisra, were in compliance with all covenants.

  As at December 31, 2005, Elisra did not comply with some of its financial covenants. Nonetheless, subsequent to the balance sheet date, a letter was received from one of the banks, waving its demand for repayment of the loan for a period of 15 months from the balance sheet date. In addition, a letter was also received from the other bank that retroactively updates the financial covenants as at December 31, 2005 (based on the actual ratios at that time) and also provides updated financial covenants for the coming years. The bank will examine these updated financial covenants on December 31, 2006, and in Management's estimation Elisra will comply with those covenants at that date. Accordingly, loans, in the amount of $10 million, are classified as long-term loans.

- As of December 31, 2005, guarantees in the amount of approximately $667,000 were issued by banks on behalf of Group companies in order to secure certain advances from customers and performance bonds.

K. Acquisitions During 2005

- During the last quarter of 2004 and during 2005, the Company purchased from Koor Industries Ltd. ("Koor") and in the market approximately 40% of the shares of Tadiran for approximately $172 million in cash, and the Company has become Tadiran's controlling shareholder.

  The excess of the amount paid for Tadiran's shares acquired during 2004 and 2005 over their book value is approximately $120 million. Based on a purchase price allocation analysis ("PPA") performed by an independent advisor, this excess, net of taxes, was attributed as follows:

	$M	Expected useful lives
In Process R&D ("IPR&D")	9.5	immediate write-off
Inventory	2.8	up to 2 quarters
Other assets or liabilities	0.7	5 years
Brand name	7.5	15 years
Customer base and backlog	37.7	2-12 years
Technology	22.3	10 years
Goodwill	39.6	indefinite – subject to annual impairment test
	120.1	

  The effect of the above transaction on the Company's 2005 results, which were reflected as part of the Company's equity in net earnings of affiliated companies, was as follows:

	$M
IPR&D write-off	(8.5)
Inventory amortization	(2.0)
Other tangible and intangible assets amortization	(4.4)
	(14.9)
Company's portion in Tadiran's results (according to U.S. GAAP)	3.8
Net effect	(11.1)

- On November 30, 2005, the Company announced the completion of the purchase of the shares of Koor in Elisra for approximately $68.8 million in cash. Following the completion of the transaction, the Company owns 70% of Elisra and Elisra's two major subsidiaries - Tadiran Electronic Systems Ltd. and Tadiran Spectralink Ltd.

The completion of the purchase of Elisra's shares was made possible following the receipt of all required approvals, including that of the Israeli Antitrust Authorities. In accordance with the Israeli antitrust approval, the Company has agreed to fulfill conditions imposed by the Antitrust Authorities related to the market environment between Elbit Systems and Israel Aircraft Industries Ltd. ("IAI"), which holds the balance of Elisra's shares. Should the Antitrust Authorities conclude, during the course of a five-year period following the acquisition, that Elbit Systems has not complied with such conditions, the Antitrust Authorities may take various measures, including steps that could result in the cessation of the joint holdings in Elisra by the Company and IAI, including the possible need for the Company to sell its shares in Elisra.

The excess of the amount paid for the Elisra's shares acquired over their book value is approximately $60.2 million. Based on a PPA performed by an independent advisor, this excess was attributed as follows:

	$M	Expected useful lives
IPR&D	7.5	immediate write-off
Inventory	1.2	up to 2 quarters
Land and buildings	5.7	20 years
Customer base and backlog	11.8	10 years
Technology	9.5	10 years
Deferred taxes	(5.4)	According to the relevant item above
Goodwill	29.9	indefinite – subject to annual impairment test
	60.2	

The results of Elisra's operations have been included in the consolidated financial statements from the date of acquisition.

Following the acquisition of Elisra's shares in the fourth quarter of 2005, the Company identified and wrote-off duplicated inventories and equipment in the amount of $3.5 million, which were recorded as restructuring expenses in the cost of goods sold (net effect of $2.6 million).

L. Summary of Financial Results

The following table sets forth the consolidated statements of operations of the Company and its subsidiaries for the three-month periods and years ended December 31, 2005 and December 31, 2004.

	For the year ended on December 31				For the three months ended on December 31			
	2005		2004		2005		2004	
	$	%	$	%	$	%	$	%
	(In thousands of U.S. dollars except per share data)							
Total revenues	**1,069,876**	100.0	**939,925**	100.0	**321,760**	100.0	**270,775**	100.0
Cost of revenues	**786,616**	73.5	**689,626**	73.4	**239,826**	74.5	**198,198**	73.2
Restructuring expenses (pre-contract and equipment write-off)	**3,488**	0.4	**-**	0.0	**3,488**	0.4	**-**	0.0
Gross profit	**279,772**	26.1	**250,299**	26.6	**78,446**	24.4	**72,577**	26.8
Research and development (R&D) expenses	**92,375**	8.6	**86,368**	9.2	**25,482**	7.9	**32,370**	12.0
Less - participation	**(20,472)**	(1.9)	**(19,522)**	(2.1)	**(7,022)**	(2.2)	**(9,094)**	(3.4)
R&D expenses, net	**71,903**	6.7	**66,846**	7.1	**18,460**	5.7	**23,277**	8.6
Marketing and selling expenses	**78,648**	7.4	**69,912**	7.4	**23,953**	7.4	**19,190**	7.0
General and administrative expenses	**54,417**	5.1	**47,832**	5.1	**16,155**	5.0	**12,876**	4.8
IPR&D write-off	**7,490**	0.7	**-**	0.0	**7,490**	0.7	**-**	0.0
	212,458	19.9	**184,590**	19.6	**66,058**	20.5	**55,343**	20.4
Operating income	**67,314**	6.3	**65,709**	7.0	**12,388**	3.9	**17,234**	6.5
Finance expenses, net	**(11,472)**	(1.1)	**(5,852)**	(0.6)	**(5,199)**	(1.6)	**(2,974)**	(1.1)
Other expenses, net	**(5,326)**	(0.5)	**770**	0.1	**(5,134)**	(1.6)	**831**	0.3
Income before taxes on income	**50,516**	4.7	**60,627**	6.4	**2,055**	0.6	**15,091**	5.6
Taxes on income	**16,335**	1.5	**15,219**	1.6	**4,046**	1.2	**3,507**	1.3
	34,181	3.2	**45,408**	4.8	**(1,991)**	(0.6)	**11,584**	4.3
Minority interest in loses (gains) of Subsidiaries	**(58)**	(0.0)	**(180)**	0.0	**(710)**	(0.2)	**(639)**	(0.2)
Equity in net earnings (losses) of affiliated companies and partnership	**(1,636)**	(0.2)	**6,645**	0.7	**(2,974)**	(0.9)	**2,059**	1.2
Net earnings	**32,487**	3.0	**51,873**	5.5	**(5,675)**	(1.7)	**13,005**	5.2
Diluted earnings per share	**0.78**		**1.26**		**(0.14)**		**0.31**	

Revenues

The Company's sales are primarily to governmental entities and prime contractors under government defense programs. Accordingly, the level of the Company's revenues is subject to governmental budgetary constraints.

The Company's consolidated revenues increased by 13.8%, from $939.9 million in 2004 to $1,069.9 million in 2005.

Following the acquisition of Elisra's shares, the Company's consolidated revenues in 2005 includes $15.7 million of Elisra's revenues.

The following table sets forth the Company's revenue distribution by areas of operation:

	Year ended			
	December 31, 2005		December 31, 2004	
	$ millions	%	$ millions	%
Airborne systems	420.8	39.3	367.9	39.1
Land systems	117.4	11.0	199.2	21.2
C^4ISR systems	217.3	20.3	108.9	11.6
Electro-optics	242.3	22.7	200.3	21.3
Other (mainly non-defense engineering and production services)	72.1	6.7	63.6	6.8
Total	1,069.9	100.0	939.9	100.0

Land systems revenues decreased by 41% from $199.2 million to $117.4 million. The decrease in land systems revenues was mainly as a result of temporary delay in some projects that the Company believes will be sold during 2006.

C^4ISR systems revenues increased by 100% from $108.9 million to $217.3 million. The increase in C^4ISR revenues resulted mainly from sales in the IMOD's Digital Army Program ("DAP") related projects.

Electro-optics revenues increased by 21% from $200.3 million to $242.3 million. The increase in electro-optics revenues resulted from increased sales of homeland security systems for international customers, night vision equipment for various customers, as well as sales of electro-optic products by a European subsidiary.

The following table sets forth the Company's distribution of revenues by geographical regions:

	Year ended			
	December 31, 2005		December 31, 2004	
	$ millions	%	$ millions	%
Israel	315.4	29.5	241.6	25.7
United States	397.5	37.2	348.5	37.1
Europe	104.2	9.7	124.1	13.2
Other countries	252.8	23.6	225.7	24.0
Total	1,069.9	100.0	939.9	100.0

The changes in revenues by geographic distribution were in the revenues from customers in Europe, which decreased mainly as a result of the temporary reduction in the land systems area of operations, while revenues in all other geographical regions increased. The increase in revenues in Israel was mainly from programs in the C^4ISR area.

Gross Profit

The Company's gross profit represents the aggregate results of the Company's activities and projects and is based on the mix of programs in which the Company is engaged during the reported period.

Following the acquisition of Elisra's shares in the fourth quarter of 2005, the Company identified and wrote-off duplicated inventories and equipment in the amount of $3.5 million, which were recorded as restructuring costs in the cost of goods sold.

Reported gross profit in 2005 was $279.8 million (with a gross profit margin of 26.1%), as compared to $250.3 million (gross profit margin of 26.6%) in 2004.

Excluding the write-off as mentioned above, gross profit in 2005 was $283.3 million (gross profit margin of 26.5%).

Research and Development ("R&D")

The Company continually invests in R&D in order to maintain and further advance its technologies, in accordance with a long-term plan, based on its estimate of future market needs.

The Company's R&D activities in the reported period are coordinated with, and partially funded by, third parties, including the IMOD and the OCS. These programs were mainly in the areas of advanced airborne systems, cutting edge electro-optics technology and products for surveillance, aerial reconnaissance, lasers and space based sensors.

Gross R&D expenses in 2005 totaled $92.4 million (8.6% of revenues), as compared with $86.4 million (9.2% of revenues) in 2004.

Net R&D expenses (after deduction of third party participation, including the IMOD and the OCS) in 2005 totaled $71.9 million (6.7% of revenues), as compared to $66.8 million (7.1% of revenues) in 2004.

Marketing and Selling Expenses

The Company maintains its activities in developing new markets and pursues various business opportunities according to the Company's plans.

Marketing and selling expenses in 2005 were $78.6 million (7.4% of revenues), as compared to $69.9 million (7.4% of revenues) in 2004.

General and Administrative ("G&A") Expenses

G&A expenses in 2005 were $54.4 million (5.1% of revenues), as compared to $47.8 million (5.1% of revenues) in 2004.

The increase in G&A expenses in 2005 compared to 2004 was related to the cost of various exploratory merger and acquisition, legal, audit and control activities, including expenses related to compliance with the Sarbanes-Oxley Act.

Financing Expenses (Net)

Net financing expenses in 2005 were $11.5 million, as compared to $5.9 million in 2004.

The increase in the net finance expenses resulted mainly from a higher level of long-term loans, currency exchange rate differences and an increase in market interest rates.

Other Expenses (Net)

Other expenses in 2005 were a $5.3 million loss as compared to a $0.8 million gain in 2004.

During the fourth quarter of 2005, the fair value of ImageSat International N.V. ("ISI"), an approximately 14% affiliate of the Company, decreased as a result of a decrease in ISI's backlog and estimated future cash flows. Based on a valuation performed by an independent advisor, the Company wrote-off approximately $5.4 million of its investment in ISI.

Taxes on Income

The Company's tax rate represents a weighted average of the tax rates to which the various companies in the Group are subject. The change in the effective tax rate is attributable mainly to the mix of the tax rates in the various tax jurisdictions in which the Group's companies generating the taxable income operate and the continued decrease in the tax rate in Israel.

Provision for taxes in 2005 was $16.3 million (tax rate of 32.3%), as compared to a provision for taxes of $15.2 million (tax rate of 25.1%) in 2004.

Excluding the IPR&D related to Elisra and the write-off related to ISI, which are not deductible for tax purposes, the Company's effective tax rate was 25.8%.

Company's Share in Earnings of Affiliated Entities

In 2005, the Company had net expense of $1.6 million from its share in earnings of affiliated entities, as compared to an income of $6.6 million in 2004.

The Company's share in 2005 includes the write-off of IPR&D related to the acquisition of Tadiran's shares, which amounted to $8.5 million.

Excluding the IPR&D write-offs, the Company's share in earnings of affiliated entities in 2005 was a net income of $6.9 million.

The companies and partnerships, in which the Company holds 50% or less in shares or voting rights and are therefore not consolidated in its financial statements, operate in complementary areas to the Company's core business activities, including electro-optics, airborne systems and communications. This includes the Company's share in the earnings of Tadiran and reflects the impact of the corresponding purchase price allocation adjustments described above.

Net Earnings and Earnings Per Share ("EPS")

Reported net earnings in 2005 were $32.5 million (3.0% of revenues), as compared to reported net earnings of $51.9 million (5.5% of revenues) in 2004. Reported fully diluted EPS was $0.78 in 2005, as compared to $1.29 in 2004.

Excluding the IPR&D and write-offs related to Tadiran and Elisra, which amounted in 2005 to approximately $18.6 million, net earnings in 2005 were $51.1 million (4.8% of revenues) and the EPS was $1.23, as compared to $52.9 million (5.6% of revenues) and an EPS of $1.29 in year ended December 31, 2004.

The number of shares used for computation of diluted EPS in the year ended December 31, 2005 was 41,623 thousand shares, as compared to 41,041 thousand shares in the year ended December 31, 2004.

M. **Liquidity and Capital Resources**

The Company's net cash flow generated from operating activities in 2005 was $187.6 million, resulting mainly from net income and advances received from customers. The cash inflows were partially offset, mainly by an increase in inventories and by payments of trade payables.

Net cash flows used for investment activities in the year ended December 31, 2005 were $241.7 million, which was used mainly for acquisition of Tadiran's and Elisra's shares and for procurement of various assets and equipment.

Net cash flow derived from financing activities in 2005 was $113.9 million, which was mainly from receipt of long-term loans.

On December 31, 2005, the Company had total borrowings in the amount of $262.6 million, including $225 million in long-term loans and $667 million in guarantees issued on its behalf by banks, mainly in respect of advance payment and performance guarantees provided in the regular course of business. On December 31, 2005, the Company had a cash balance amounting to $93.9 million.

The Company and some of its subsidiaries operate with loan and credit agreements that contain certain covenants. Such covenants include requirements for shareholders' equity, current ratio, operating profit margin, tangible net worth, EBITDA, interest coverage ratio and total leverage. As of December 31, 2005, the Company and its subsidiaries are in compliance with all such covenants.

As of December 31, 2005, the Company had working capital of $227 million and its current ratio was 1.37. The Company's ratio of equity to total assets was 27.8%.

N. Derivatives and Hedges

Market risks relating to the Company's operations result primarily from changes in interest rates and exchange rates. The Company typically uses financial instruments to limit its exposure to those changes. The Company also typically enters into forward contracts in connection with transactions that are denominated in currencies other than U.S. dollars and New Israeli Shekels ("NIS"). The Company may enter from time to time into forward contracts related to NIS, based on market conditions.

On December 31, 2005, the Company's liquid assets were comprised of bank deposits, and it had no investments in liquid equity securities that were subject to market fluctuations, except for the Tadiran shares acquired as mentioned above. The Company's deposits and loans are based on variable interest rates. Should interest rates either increase or decrease, such change may affect the Company's results of operations due to changes in the cost of the liabilities and the return on the assets that are based on variable rates.

The Company's functional currency is the U.S. dollar. On December 31, 2005, the Company had exposure due to liabilities denominated in NIS of $37 million in excess of its NIS denominated assets. These liabilities represent mostly wages and trade payables. The amount of the Company's exposure to the changes in the NIS-U.S. dollar exchange rate varies from time to time.

Most of the Company's assets and liabilities which are denominated in currencies other than the NIS and the U.S. dollar were covered as of December 31, 2005 by forward contracts and options. On December 31, 2005, the Company had forward contracts for the sale and purchase of such foreign currencies totaling $220 million ($22 million in Euro, $194 million in GBP and $4 million in other currencies). The financial derivative activities in the fourth quarter of 2005 resulted in an unrealized net gain of approximately $6.3 million, which was recorded as other comprehensive income.

O. Dividends

The Board of Directors declared on March 13, 2006 a dividend of $0.14 per share for the last quarter of 2005. The total dividend declared for 2005 was $0.54 per share.

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